SUPERVISORY AND REGULATORY ACTIVITIES ARE KEY TO FDIC'S SUCCESS

FDIC's supervisory and regulatory responsibility is designed to ensure the safety and soundness of federally insured depository institutions. FDIC is the primary federal regulator for over 6,300 state-chartered banks whose deposits are covered by FDIC insurance funds. The Corporation also has certain backup supervisory authority, for safety and soundness purposes, for state-chartered banks that are members of the Federal Reserve System, national banks, and savings institutions. With the increased financial strength of the banking industry, the number of failed banks has decreased considerably. During the calendar years 1995-1996, 12 banks failed compared to 54 banks that failed in the years 1993-1994. In this rather healthy environment, FDIC's focus is on identifying and addressing the potential risks to the banking industry and deposit insurance funds rather than on resolving failed institutions. FDIC's challenge continues to be to maintain the viability of the federal deposit insurance funds by identifying and taking action on any institution involved with activities that are unsafe, unsound, illegal, or improper before the activities can become a drain on the insurance funds.

The banking industry is a rapidly changing marketplace, with fewer yet larger and more complex institutions, which are moving into such new services as cyberbanking and smart cards. It is also an industry susceptible to regional and economic sector fluctuations in the economy. Further, there is continuing interest in legislative changes affecting the banking industry, such as merging bank and thrift charters. All these variables present challenges that the Congress and public look to FDIC to manage in a manner that ensures the safety and soundness of banking institutions and the insurance funds that back depositors.

OIG REVIEWS CAUSES OF BANK FAILURES

The OIG can play a key role in assisting the Corporation in its efforts to identify the risks to the banking industry and bank insurance funds. During the reporting period, the OIG conducted two reviews that focused on the causes of bank failures. One such review was a material loss review of the failure of the Bank of Newport, Newport Beach, California. This review identified the causes for the failure of a specific bank, as required by section 38(k) of the Federal Deposit Insurance Act. In this review, the OIG determined that the Bank of Newport failed because of (1) fraudulent lease transactions, (2) weaknesses related to loan underwriting practices, (3) a concentration in construction and development loans, and other commercial real estate loans, (4) high overhead expenses, and (5) inadequate oversight by the bank's management.

The OIG also conducted another review and made a broader assessment of all bank failures over the course of a year, to complement the more detailed assessments of the causes for failure of the specific bank identified in the material loss review. The overall goal of this review was to identify the institutional practices which caused the 1995 failures and respective losses to the Bank Insurance Fund (BIF). The specific objectives were to identify the key problems of insured bank failures that occurred in 1995 and identify any trends or unique characteristics among the failed institutions.

During 1995, six banks insured by the BIF failed, with combined assets of $867 million. Estimated losses to the BIF, at the time of failure, totaled more than $77 million. The principal conditions of failure that were common to most of the 1995 failed banks included (1) weak loan underwriting, (2) concentrations of credit, (3) high overhead expenses, (4) imprudent bank management, and (5) negative economic factors. Our report on the 1995 bank failures was informational and did not include recommendations. DOS management did, however, inform us of recent projects that emphasize changes in the examination process regarding our reported issues, including a more structured risk assessment approach in the safety and soundness examination program and a pilot program that allows users to generate market data for selected property types.

CORPORATION IMPLEMENTS I